

BEYOND BUDGETING: BOON OR BOONDOGGLE?

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Abstract

Top managers and controllers increasingly voice dissatisfaction with budgeting as a planning and controlling instrument. Since the end of the 1990s, practitioners and researchers therefore have developed increasingly more systematic, alternative concepts to traditional budgeting. This article examines three of them: Better Budgeting; Advanced Budgeting; and Beyond Budgeting. Member firms belonging to the Beyond Budgeting Round Table have been reporting on their experiences with these reform concepts for several years. How likely is it that any one of them can solve all the problems associated with traditional budgeting?

After examining the evidence, this article offers critical evaluations of the three new concepts, suggests additional measures for creating leaner and more flexible budget processes, presents the perspective of some IT-suppliers on supporting Beyond Budgeting, and answers the question of who should be onboard to implement any changes. Following a discussion of the pragmatism evident in the way two companies have modernized their planning and controlling systems, the article draws summary conclusions.

Key words: Advanced Budgeting, Balanced Scorecard, Better Budgeting, Beyond Budgeting, Controlling, Process-based budgeting.

JEL Classification: M40, M41, M42.

Introduction

Budgeting's primary purpose is to support management in successfully implementing its strategies as well as in planning and controlling its operational measures. A highly structured process, budgeting makes myriad multidimensional, planned actions within an organization comparable by valuing them in money. Once adopted, a budget authorizes the consumption of resources up to specified amounts in order to execute those actions plans. Comparison of plan data in budgets with actual or standard results also reveals variances, signaling a need to improve planning methods or to change operational procedures both within and across business units. The budgetary process thus greatly facilitates overall coordination and control of activities at the level of the firm or its major divisions.

As many empirical studies show, organizations therefore overwhelmingly regard budgeting as their most important controlling instrument. For example, 84% of Austrian companies surveyed agreed that analysis of differences between budgeted and actual results is the absolutely essential, primary task of controlling. They also agreed that comparative analysis of actual results with standard costs in flexible budgets constitutes the most important element in operational controlling. Surveys conducted in Germany have produced similar findings (Özel, 2003).

Yet despite its widespread employment, top managers and controllers increasingly voice dissatisfaction with budgeting as a planning and controlling instrument. For instance, a survey of European enterprises conducted in 2003 showed managers generally agreeing that their planning and budgetary processes were ineffective and, above all, inefficient -- even though most interviewees only could guess at the amount of resources committed to them. Simply put, respondents believed these processes yield small benefits relative to the (supposedly) large amounts of resources they consume. Accordingly, 78% of the surveyed firms planned changes in their budgetary processes, while a small circle of 12% even contemplated abandoning budgeting altogether (Oldiges, 2003).

Dieter Brandes, former CEO and member of the oversight board of the German discount supermarket chain Aldi North, is one top manager who finds budgets completely superfluous. In his view, controllers think up too many new ideas (*e.g.*, balanced scorecards, integrated performance management, operational performance measurement, value-oriented controlling, investment

risk portfolios, push-button controlling, high-end controlling, consolidation of complex value chains, and so forth) and overestimate their competence. As a result, they contribute considerably to the growing complexity associated with managing a business. This complexity is readily apparent in their fixed, detailed, costly, and altogether unnecessary annual budgets. Furthermore, assisted by computers and standardized software, controllers nowadays inundate managers with so much information that they often lose sight of what really is existentially important. Indeed, Brandes finds himself in agreement with the late business administration guru Peter Drucker's observation that managers probably are worse informed about their company's operations today than they were 30 years ago (Brandes, 2004).

Among the North American managers sharing Brandes's opinion is Jack Welch, former CEO of General Electric, the world's largest corporation. Arguably the 20th century's most successful executive, Welch asserts that, "The budget is the bane of corporate America!" He also believes top management has to deal with too many numbers. In his experience, just three numerical key performance indicators are sufficient to manage any enterprise on earth: cash-flow; customer commitment; and employee motivation (Welch and Byrne, 2001).

Consequently, since the end of the 1990s, practitioners and researchers have developed increasingly more systematic, alternative concepts to traditional budgeting. Most notable among them are Beyond, Better, and Advanced Budgeting. Recently all three have gained prominence as proposed solutions to traditional budgeting's perceived problems. The key difference among them pertains to how radically they propose to change a firm's planning and controlling systems. Better Budgeting and Advanced Budgeting focus on boosting the benefits of budgeting and/or reducing the resource consumption associated with it. Hence, both concepts retain budgeting as the key instrument within a controlling system. In contrast, Beyond Budgeting calls for far more basic change. It aims at so fundamentally transforming a company's management model that controlling via budgets becomes redundant.

To present a fuller picture of the critics' arguments, this article begins by examining additional reasons for their advocacy of Beyond Budgeting. It then discusses the concept's basic principles and briefly describes some reported examples of its use. Next, the article examines some of the instruments associated with Beyond Budgeting, before turning to the notions of Better and Advanced Budgeting. Thereafter, it offers critical evaluations of all three reform concepts, suggests additional measures for creating a leaner and more flexible budget process, presents the perspective of some IT-suppliers on supporting Beyond Budgeting, and answers the question of who should be onboard to implement any changes. Following a discussion of the pragmatism evident in the way two companies have modernized their planning and controlling systems, the article draws summary conclusions.

Additional Reasons for Beyond Budgeting

Besides traditional budgeting's complexity and unfavorable cost-benefit relationship, several other factors have led some managers to advocate a new controlling paradigm. Among these factors are changes in an enterprise's internal processes associated with the transition from the "sellers' market" of the industrial age to the "buyers' market" of the high-tech age. Organizational structures for purchasing, production, and sales, which originated in the functional division of labor characterizing the industrial age, are giving way more and more to processing chains linking suppliers with customers. Likewise, assumptions about linear relationships between input and output are yielding to dynamic, customer-oriented combinations of flexible business systems in the high-tech age. Because traditional budgeting also is a product of industrial society, post-industrial business administration plausibly requires one or more controlling instruments with greater flexibility.

The Beyond Budgeting concept addresses these developments by focusing on the attainment of two goals:

- Greater flexibility in controlling through a transition from the traditional management model of "production and sales" to a radically reformed model of "market preview and production based on customer demand".

- Self-organization and self-controlling for the purpose of self-optimization through a transition from hierarchical management principles to network organizations with decentralized responsibility and decision-making by empowered, motivated employees.

- In this regard, some critics see the *central* problem of traditional budgeting lying in its use by executives as the foundation for outmoded, fixed performance contracts with subordinated managers and employees (Kraus, 2006). According to these critics, budget-based performance management is the wrong way to provide leadership to an enterprise and to control the progress made toward reaching its goals. They particularly criticize the following aspects of traditional budgeting:

- **Budgets lack sufficient strategic orientation:** traditional budgets concentrate on a firm's functional areas, divisions, and departments as well as on cost reduction and short-run profit goals rather than on the long-run, value-oriented implementation of its strategy.
- **Budgets ignore the turbulence of markets:** in dynamic, regionalized or globalized markets, marked by rapidly changing, highly individualized customer demands and other distinctive influences, the formulation of budgets and fixed performance contracts from 12 to 15 months in advance of actual business transactions makes little or no sense.
- **Budgets lead to inappropriate (*i.e.*, unethical) management behavior:** when the attainment of budget goals constitutes the compulsory standard for performance evaluation, subordinate managers and employees will do everything they can in order to reach them (Jensen, 2001). However, optimization of an individual manager's performance often may come at the expense of the company's long-run, value-oriented development. Adelphia Communications, Arthur Andersen, Barings Bank, Eastman Kodak, Enron, KPMG, MCI, Parmalat, Royal Ahold, Sunbeam, Tyco, and WorldCom are only a dozen of the many, many recently reported examples of this phenomenon, which nearly, or indeed, has led to the enterprise's collapse.

Principles of Beyond Budgeting

Founded in 1997 and initially attended by 34 firms, the Beyond Budgeting Roundtable (BBRT) subsequently has grown to more than 70 members. By 2005, it also had spawned a German offshoot, the Beyond Budgeting Summit. Company practitioners and consultants predominate in both organizations, but each includes a few academics too. Member businesses are engaged in developing a new controlling model, which will enable them to meet better challenges arising from the heightened dynamism and growing importance of immaterial asset values in their environments.

Working meetings of both Beyond Budgeting organizations take place at regular intervals. Initially, these meetings focused on analysis of the problems of traditional planning and controlling systems as well as definition of fundamental principles to guide creation of new management systems. Nowadays, though, the working sessions concentrate more on introducing new instruments devised for Beyond Budgeting and sharing insights gained from their use.

Drawing on more recent developments in management theory, Beyond Budgeting's advocates have identified various principles for reforming an enterprise's planning and controlling systems (Daum, 2002; Hope and Fraser, 2003; Pfläging, 2003). One can categorize them as either leadership principles, which should improve the firm's culture, or as performance principles, which should guarantee more effective action.

From a management viewpoint, the most frequently mentioned leadership principles include the following ideas:

- By liberating all managers and employees from their dissatisfaction with the controlling system currently in place and motivating them with shared values, a company can mobilize enormous innovative potential.

- By creating profit centers to decentralize responsibility for producing results, instruments for self-controlling, and allowing subordinates more latitude for decision-making, an enterprise can encourage all managers and employees to engage in entrepreneurship.

- By decentralizing decision and performance responsibility to operational levels as well as empowering managers and employees to engage in self-controlling and “management by exception”, a more customer-oriented, network organization also can emerge.

- By implementing a coach-and-support leadership style, a firm’s top management only has to intervene in operations in a subsidiary way, if decentralized managers request support or are unable to solve a problem.

- By relying on both internal and external markets, a company needs neither plans nor budgets to coordinate its activities.

- By making requisite information available to everyone, everywhere, and in real time, an enterprise can achieve greater transparency and division of control.

The objective of all these principles is to change a firm’s culture for the better. To do so, Beyond Budgeting strives to make controlling systems more flexible by substituting independent coordination through a network organization for the traditional, hierarchical model of managing a company.

From a controlling viewpoint, the most frequently mentioned performance principles include the following notions:

- Instead of relying exclusively on budgetary goals, an enterprise should focus its planning and controlling more on selected non-monetary performance indicators.

- Instead of setting internally-oriented revenue and cost targets for controlling purposes, a firm should employ self-adjusting, performance-enhancing benchmarks oriented on internal or external competitors.

- Instead of the entire firm, its principle functions, or divisions, a company’s top management should adopt a controlling perspective extending more deeply into embedded reporting levels (e.g., individual products, customers, regions, or sales channels).

- Instead of relying on input-oriented cost categories in planning and budgeting, an enterprise should base its controlling system on output-oriented processes.

- Instead of budgeting once a year for a twelve month period, a company should use a dynamic, rolling approach – by adding another month or quarter to its budget plan every time a month or quarter ends -- thereby coordinating its activities with its strategy more continuously.

- Instead of undertaking strategic planning in isolation from operations, a firm should integrate its strategic planning with its operational budgeting to ensure adequate funding for activities intended to implement the strategy.

- Instead of numerous, highly detailed, small sub-budgets, a company should create fewer, less detailed, more global budgets and allow its operational managers to reallocate resources within them as the situation may require.

- Instead of allocating capital resources centrally, a firm also should make its investment decisions at the level of individual divisions, coordinating them via a centrally determined ROI- (cash-flow-ROI-, EVA- or SVA-) goal.

- Instead of relying on historically-oriented financial data, an enterprise should have an anticipative information system, which supports the use of early warning systems employing non-financial data and permits continuous updating of business strategy, investments, and operational decisions as environmental conditions change.

- Instead of restricting the eligibility for (large) bonuses to a few individuals at the highest management levels, firms should employ a team-based incentive system, which, in the event of success, affords all team members approximately equal, moderate rewards in order to encourage teamwork and cooperation, while conserving resources.

Underlying these performance principles is the intention to eliminate budgeting largely or entirely, thereby creating necessary preconditions for a more flexible, innovative, and frugal organization. When introduced in combination, Beyond Budgeting’s leadership and performance principles supposedly lead to greater congruence between a company’s strategy and its operational

activities, more flexibility and adaptability as well as less dysfunctional behavior on the part of its management and employees, lower costs (due to reduced consumption of manpower, time, and money), and thus increases in both economic and shareholder value.

Condensed Case Studies

Of course, the requisite adaptation, introduction, and integration of new instruments embodying the above leadership and performance principles into a given firm's controlling system occur in a series of steps. Hence, the professional literature contains a growing number of reports about well-known companies in various stages of successfully integrating Beyond Budgeting propositions into their management processes. Although highly condensed, the following case studies, presented at the 2003 BBRT in London, generally reflect the efforts currently underway.

Svenska Handelsbanken

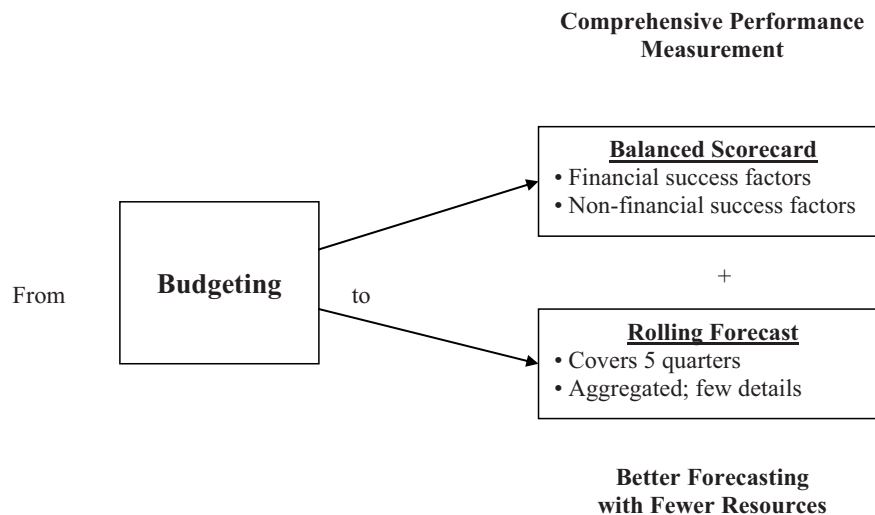
The Swedish Svenska Handelsbanken has done without a traditional budget for more than 30 years, relying instead on a radically decentralized organizational structure. Today highly profitable, this company was the birthplace of Beyond Budgeting. During a severe crisis in the early 1970s, a new management team laid the foundation for it by creating a flat and simple organizational structure. Ever since, Svenska Handelsbanken has had only four hierarchical levels and frontline managers have had responsibility for its customers. Besides the flattened hierarchy, additional factors believed to have contributed to Beyond Budgeting's successful implementation at the bank include: direct communication between top management and the rest of the organization; a lean controlling system, based on just a few market-oriented key performance indicators; and an incentive system, which in the event of management success, guarantees every employee the same bonus.

Borealis

Borealis, a leading European petrochemical manufacturer, stopped using budgets in 1996. Prior to that date, there long had been general dissatisfaction with the company's budgeting practices. This dissatisfaction stemmed from the dual roles budgets had played. On one hand, they set an upper limit on costs. On the other hand, they also constituted an effective floor or base amount for expenditures. Managers generally tended to spend whatever amounts the budget authorized because unexpended sums at year-end could prompt funding cuts for the following year. Wasted resources were often the result. Moreover, top management did not understand budgeting as an ongoing process that continuously takes an enterprise's changing environment into consideration. Instead, it viewed budgeting as an annual one-shot exercise, which committed sizable resources for a considerable period of time.

Following a merger in 1996, the new top management then began introducing other instruments and mechanisms. It decoupled financial controlling from performance evaluation. Although previously financial budgeting had been the main focus of controlling activities, Borealis based its new controlling concept on the broader, more comprehensive notion of management performance depicted in Figure 1. Like a balanced scorecard, it tracks both monetary and non-monetary performance indicators. In doing so, it also employs a rolling financial forecast with a time horizon of 5 quarters. This rolling forecast makes financial controlling on an aggregated level possible. Improved methodologies for controlling fixed costs and investments round out the firm's Beyond Budgeting tools.

Top management forced the new tools' adoption throughout the organization. Consequently, the instruments soon were firmly in place, while, in contrast, the company's culture continued to change only slowly in the direction of greater decentralization and employee empowerment.



Source: Adapted from T. Bolsen, "Borealis," The First Annual Beyond Budgeting Summit, London, 2003.

Fig. 1. Planning- and Performance-Measurement-System at Borealis

When another new top management team took over, it re-introduced budgeting at Borealis. For example, the enterprise now formulates a financial plan. Nevertheless, one cannot say formulation of this plan marks a return to traditional budgeting. The firm has not gone back to preparing a comprehensive budget with its time-consuming, complex rounds of negotiations. In addition, financial plans no longer constitute the basis for fixed performance contracts as they did formerly.

Unilever

Great general dissatisfaction with the traditional budgeting process likewise preceded Unilever's development of a Beyond Budgeting concept. Top management could not accept spending nearly 6 months a year formulating marketing budgets that one had to reduce repeatedly during the subsequent six months. It therefore decided to introduce Beyond Budgeting over a three-year-long period. This interval allowed managers, controllers, and employees time to engage in a learning process, becoming increasingly familiar with the concept the new instruments involved. It also facilitated gradual change in the company's culture.

After extensive preparations, Unilever's top finance and controlling executives explained the main ideas of Beyond Budgeting at an informational meeting for managers and employees. Numerous grassroots workshops then little by little developed a visionary controlling model for the entire Unilever concern. Next, groups of practitioners spent two years creating the requisite new controlling instruments and testing them in various pilot studies. Unilever's top managers foresaw further refinement of these instruments through feedback from the studies before beginning to roll out the concept across the concern in 2005.

Rhodia

Dissatisfaction with its traditional budgeting process also was the starting point for cultural change at Rhodia, a French chemical concern. Management decided to accord efficiency in that process higher priority than exactness. The resulting change project focussed on integrating the action plans implemented by its various operational units into the firm's overall, long-term strategic planning. Instead of developing action plans within the framework of detailed, comprehensive budgets, Rhodia's managers now derive them directly from the company's balanced scorecard. They then revise the action plans as necessary on a quarterly basis in keeping with a rolling forecast. The time saved is available for value-added activities.

UBS AG

In seeking ways to improve existing budgeting systems at UBS, it became apparent that the business plan is the most important controlling instrument. The company's strategy and balanced scorecard lay the foundation for this plan. External benchmarks, risk estimates, and alternative measures for contingencies also are among its important elements. The business plan furthermore identifies both monetary and non-monetary key performance indicators in order to deepen readers' understanding of the firm's operations and activity drivers. At the business unit level, budgets no longer are in use. However, their subordinate entities are free to formulate budgets for attaining their goals, which is what the latter typically do.

UBS finds that employment of a BSC overcomes traditional budgeting's historical and financial orientation, inclusion of contingency measures heightens flexibility, and use of benchmarks increases market orientation while reducing dysfunctional behavior. At organizational levels still relying on it, the budgetary process has become more efficient, more flexible, and more effective.

BASF-IT Services

BASF IT-Services had two centrally determined objectives for its Beyond Budgeting concept: (1) decreasing the uncertainty associated with planning and (2) speeding up the entire process. It attained its first goal by making the planning system leaner. That involved reducing the number of cost centers and aggregating cost categories. To achieve the second goal, BASF IT-Services made the formerly static budget more flexible by switching to rolling forecasts and updating plan values monthly.

German Railways (Deutsche Bahn)

The core goals for German Railways in re-shaping its planning system were greater market orientation and transparency as well as increased motivation through clearer lines of responsibility. Here, too, the concern did not abandon budgeting. Instead, it switched from a traditional, static budget based on functional departments to process-based budgeting. High fixed costs, associated especially with the management of rolling stock (shunting, maintenance, re-provisioning, cleaning, waste removal, and so forth) dominate its business. The new process-based budgeting facilitated controlling of market- and product-oriented systems, helped rationalize product pricing, and permitted clearer assignment of responsibility in performance evaluations.

New Controlling Instruments and Models Based on Beyond Budgeting

Despite the alluring advantages promised by its supporters, Beyond Budgeting so far has replaced the classic controlling model in just a few firms. In most cases, traditional budgeting and fixed performance contracts remain the preferred instruments for steering an enterprise along the course of development management has planned for it.

Even early implementers of the Beyond Budgeting concepts just described in the seven case studies generally have not abandoned budgeting altogether. At some organizational level, some form of budgeting lives on at Unilever, UBS, Borealis, BASF-IT Services, and German Railways. Given the accusations of mismanagement and accounting irregularities levelled at French Finance Minister Thierry Breton, Rhodia no doubt wishes it also had retained budgeting as a controlling tool to a greater extent (Kanter, 2005; 2006). The charges arise from his service on the firm's board and as president of its auditing committee from 1999 to 2002, the period when management introduced Beyond Budgeting.

The fact that so many companies continue to do so much budgeting recently has led the new paradigm's proponents to ask themselves, whether it really is all just about budgets or budgeting. Lennart Francke, CFO of the Svenska Handelsbanken, says his firm's success does not derive mainly from the elimination of budgets. Likewise, Robin Fraser, Founder and Director of the BBRT says, "Budgeting is not the big issue!" In his view, Svenska Handelsbanken and other Beyond Budgeting businesses are successful because the concept makes a company more attractive as an employer. That greater attractiveness, in turn, enables it to recruit more talented employees, thereby increasing the organization's potential, and ultimately improving its financial performance (Klein, 2005).

A consensus thus has emerged recently among Beyond Budgeting's advocates that it has less to do with budgeting than with the implementation of a new management model. Consequently, new, company-specific management models, based on the Beyond Budgeting concept, have started to appear more frequently – albeit in a supporting role. These models typically incorporate several of the following ideas:

- **Value management:** In contrast to operational budgeting, which focuses managers' attention chiefly on short-term profit maximization, value management encourages decision-making that will increase an enterprise's long-term earnings.

- **Benchmarking:** Budgets typically rely on comparisons of actual results with internal standards. Benchmarking permits comparisons of a firm's performance with that of its competitors or even best-practice organizations outside its industry.

- **Balanced scorecard:** Due also to their short-term orientation, operational budgets do not give sufficient consideration to the allocation of resources for strategic measures and programs. Balanced scorecards, on the other hand, constitute integrated, holistic, strategic leadership and information systems. They define and present relevant scores in a form that balances a company's monetary and non-monetary potentials along its finance, customer, internal process, and employee dimensions. Employing a BSC to guide their decision-making should lead managers to allocate resources so that the short-term operational measures and programs essential to attainment of long-term strategic goals receive adequate support (Boeson, 2000; 2002). By proceeding in this fashion, an enterprise assumedly is more likely to realize its strategic potentials and reap the long-term profits associated with doing so.

- **Process-based management:** Most companies organize their budgets in keeping with their organizational structures, *e.g.*, departments and divisions. That focuses managers' attention on these units. Structuring budgets according to a firm's internal processes instead directs managers' attention to activities and capacities essential to its performance in meeting customers' needs (Cokins, 2001).

- **Customer relationship management:** Budgeting annual increases in sales volumes and revenues emphasizes the short-term, monetary side of customer relations. In contrast, by incorporating non-monetary factors in its controlling system, an enterprise can strengthen its long-term, overall customer relations.

- **Information systems and rolling forecasts:** Many firms continue to rely heavily on historical data for planning and controlling purposes even though this information often no longer describes reality accurately. In contrast, modern information systems employ future-oriented data to generate prognoses that will assist managers in making forward-looking decisions.

Better Budgeting and Advanced Budgeting

Although Beyond Budgeting now may have more to do with a new management model than with budgeting *per se*, it still engenders questions about how businesses can reform their budgets and budgetary processes short of abandoning them altogether. The condensed case studies above suggest some answers. Yet whereas five of the seven companies continue to budget, it may be more appropriate to regard them as examples of Better Budgeting or Advanced Budgeting.

Better Budgeting concentrates on simplifying traditional budgeting by improving its functional and institutional aspects. For example, it seeks to reduce the number of planning objects by budgeting only for those business processes deemed crucial to the company's success. Controllers then analyze these core or main processes more thoroughly, planning them from the ground up, and not simply by extrapolating from historical data.

Advanced Budgeting constitutes a sort of middle road between Better Budgeting (incremental change) and Beyond Budgeting (radical change). The concept has the following characteristics:

- Clear goal specification for planning and budgeting (goals derived from strategy, market- and benchmark-orientation),
- Process simplification (budgeting in detail only where it is necessary and meaningful), and
- Increased flexibility of budgets through rolling planning and self-adjusting (*i.e.*, self-correcting) goals.

Because one also can conceive of these characteristics in the form of stepwise or incremental improvements, clearly distinguishing between Better Budgeting and Advanced Budgeting is difficult. Advanced Budgeting indeed implies greater changes in traditional Budgeting than Better Budgeting does. However, there is no universal agreement about whether to classify a given reform measure as an element of Better Budgeting or Advanced Budgeting. The boundary between them is fluid. Consequently, distinctions between them depend in part on the conditions in a specific firm.

Fleshing out and implementing a budgeting concept for a particular company is in any event dependent on diverse factors, such as the complexity and dynamism of its environment or the state of its existing planning system. Figure 2 shows the relationships among traditional budgeting, Better Budgeting, Advanced Budgeting and Beyond Budgeting. Note that while the radicalism of the reform model increases from traditional budgeting to Beyond Budgeting, the number of firms (as represented by the length of the respective triangle's base) potentially using it decreases.

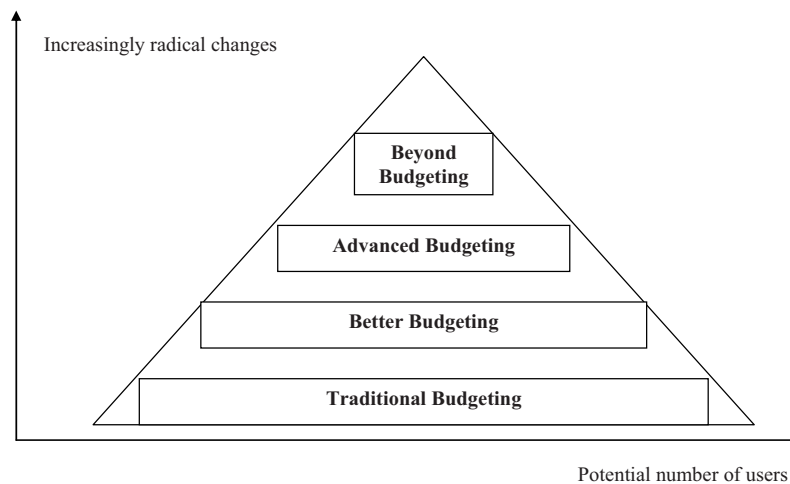


Fig. 2. Relationships among the Various Budgeting Concepts

Critical Evaluation of Beyond Budgeting

Up to the present, the arguments put forward by Beyond Budgeting's advocates have not convinced most controllers to adopt it. The main reason for their failure to do so may be due to the notion's rather generally formulated leadership and performance principles. They offer little that is really new. Instead, they merely combine already familiar management maxims in a thin conceptual wrapper and market them as bundled goods. Beyond Budgeting's proponents therefore will have to do considerably more development work and gain much more practical experience implementing their ideas before they can expect their new controlling philosophy to achieve a breakthrough with practitioners. In addition, this concept has problems relating to its small circle of potential users, its underlying premises, the difficulty of managing without budgets, shortcomings of the BSC widespread fear of change, an unfavorable cost-benefit relationship, and the lack of empirical evidence concerning its use.

Small Circle of Potential Users

Although certainly an intriguing proposition, Beyond Budgeting in any case still is in a very early stage of development. For those enterprises that might be likely candidates for its introduction, the concept eventually may prove beneficial. But even Beyond Budgeting's champions estimate the proportion of appropriate candidates to be only 10-20% of the bigger budgeting businesses. For them, the unbundling of budgeting functions could lead to a more precise goal orientation as well as higher flexibility because, on the whole and over the longer term, they may be able

to reduce or eliminate costs associated with resource allocation decision-making at the highest management levels. Furthermore, they well may need a new management model because Balanced-Scorecard users often encounter severe problems integrating it into a controlling system based on traditional budgeting.

Premises

Within the small circle of appropriate candidate firms, the reasonableness of an application of Beyond Budgeting principles depends on a series of premises not mentioned in many publications on the subject. For example, several authors assume an age of discontinuous change, unpredictable competition, and fickle customers as generally prevailing conditions. These assumptions, though, certainly are not equally valid for every company. Hence, in every case management has to check whether the assumptions of higher dynamism and greater intensity of competition really apply to its business. It likewise has to verify, whether the enterprise actually can realize the postulated flexibility potentials to as great an extent as Beyond Budgeting's supporters suppose. Are the needed relevant factors of production really obtainable on a JIT-basis? Or readily transferred to alternative uses within the organization? Can one simply terminate their employment, without having to plan and budget for such a step in advance?

The Difficulty of Managing without Budgets

Often one must plan the allocation of resources far in advance of their actual use. That greatly limits the amount of flexibility likely to result from implementing Beyond Budgeting. For instance, careful material flow planning and budgeting constitute the basis for controlling inventories in the manufacturing and merchandising sectors. Without budgets, unclear production and/or sales planning would result, leading not only to unused capacities, but also to conflicts about their short-term use. That, in turn, could increase throughput times or lead to uncontrollable growth in inventories. Anyone in these sectors believing one can abandon resource allocation planning (which, apparently only the fewest controllers do), therefore should at least prepare a budget based on the average inventory turnover planned for the accounting period involved.

For similar reasons, it would seem most imprudent for any company to forego preparation of a cash budget as part of its liquidity planning. Moreover, under the U.S. Sarbanes-Oxley Act or Germany's KonTraG legislation, top management may be committing a criminal act (failure to exercise adequate control) by neglecting to do so.

In addition, without production, sales, and cash-flow budgets, the credit rating required by banks under Basel II would become practically unattainable. Without such budgets, attempts to persuade a court to allow a business to emerge from bankruptcy almost always would be unsuccessful. Their absence would discourage many prospective parent companies from acquisitions and many prospective partner firms from mergers. Over and above these drawbacks, abandoning budgeting would undermine management's credibility in providing forward-looking information to stockholders, analysts, and other interested parties.

Shortcomings of the BSC

Some proponents of Beyond Budgeting suggest substituting BSCs for budgets as the main controlling instrument (Horváth, 2005). Yet despite its many merits, the BSC is not a *Wunderwaffe* destined to cure all of management's controlling ills. On the contrary, attempts to develop and introduce BSCs are fraught with difficulties, especially in small and middle-sized enterprises (SMEs) (Rickards, 2007).

For instance, the use of BSCs presumes that a firm has one or more concrete strategies in place. So strategy development must precede balanced scorecards. SMEs, whose top executives lack the ability to think strategically, unlikely will be able to compensate for this deficiency, even if they can afford to employ external consultants. Consequently, it does not make much sense for them to attempt to create and use BSCs.

Furthermore, balanced scorecards only can increase the transparency of decision-making within a business, if that is what top management wants them to do. In other words, a company's culture constrains the possibilities for effective implementation of BSCs. In corporate cultures,

where employee empowerment via task delegation, clear ordering of responsibility, and individualized, goal-oriented incentives are unknown, BSCs prove ineffective.

Moreover, the less developed an enterprise's planning and controlling systems are, the more problems it likely will encounter in creating and using BSCs. Discussions about balanced scorecard development can contribute to making existing deficits in the planning and controlling areas abundantly clear. Before attempting to introduce BSCs, however, an SME needs to eliminate those deficits. Thus, the introduction of balanced scorecards does not obviate the need for other planning and controlling instruments. Instead, it requires their results as inputs.

As a result, BSC use by practitioners still is not widespread. For example, although 24% of the largest German firms have experimented with them, only 11% of middle-sized and 4% of small firms have done so (Töpfer, Lindstädt, and Förster, 2002). Moreover, of the BSCs developed, over 50% are rubbish (Paul, 2004).

Cost-Benefit Relationship

There is no detailed set of general instructions readily available explaining how to introduce a Beyond Budgeting concept successfully into a real-world business. Consequently, any attempt to implement one necessarily involves the high costs usually incurred in breaking new ground. Exacerbating this situation is the fact that Beyond Budgeting encompasses a bevy of fundamental changes in a company's management culture and processes. Every enterprise therefore has to tailor its own solution by choosing appropriately from the proffered *mélange* of individual principles and proposed instruments. Often the anticipated potential improvement (benefit) will not justify the associated high costs.

Fear of Change

Fear associated with change also may account for a portion of the resistance to implementing Beyond Budgeting. Overcoming it is especially difficult in hierarchical organizations. On one hand, superiors don't dare delegate authority to make changes to subordinates for fear the underlings' performance may outstrip their own. On the other hand, many subordinates shrink from accepting the responsibility of initiating changes for fear of displeasing their bosses. (With CEOs like Jack Welch boasting about firing 10 percent of their managers every year, it is easy to grasp why such fear is commonplace.)

A related form of fear has to do with the know-how needed to use controlling and budgeting tools. Individuals possessing it may inspire fears of inadequacy in those persons having know-how deficits. A new controlling paradigm obviating the need for budgets, however, reverses this situation. Then, the staff members with budgeting know-how potentially could lose much of their value to the organization.

Insufficient Empirical Evidence

The condensed case studies presented earlier constitute at best initial findings that certain firms under certain circumstances may be able to introduce certain elements of Beyond Budgeting successfully. Beyond these reports, though, there has been a dearth of empirical evidence about the concept's implementation. Without more information about how well managers, controllers, and employees operate in a Beyond Budgeting culture, most skeptics will remain unconvinced. Furthermore, the arguments put forward by the concept's advocates would be more persuasive if they also included lessons learned from unsuccessful attempts to implement Beyond Budgeting reforms. Hopefully, studies appearing in the near future will remedy such serious deficiencies in the research reported heretofore.

Until those studies appear, a good amount of doubt about Beyond Budgeting's efficacy will remain warranted:

- How exactly should controlling take place without detailed financial numbers, especially in times when a business may be confronting a crisis?
- To what extent does the concept solve an enterprise's practical budgeting problems?

- Can a given company really make all of the cultural changes called for by Beyond Budgeting?
- Do the changes sought justify the short-term, high risks and costs involved?
- What basis will the firm have for communicating its position to stakeholders, capital markets, rating agencies and so forth, without the availability of detailed budgets?
- Is the organization's top leadership aware that its real work in implementing this new management paradigm just begins at the point, where the professional literature leaves off? *I.e.*, does it recognize there are no roadmaps showing the shortest, surest, or best way to move a business Beyond Budgeting?

Critical Evaluation of Better Budgeting and Advanced Budgeting

In contrast to their resistance to Beyond Budgeting, practitioners have been more receptive to the ideas of Better Budgeting and Advanced Budgeting. Neither of these less radical propositions calls for a complete makeover of the corporate culture. The requisite instruments are readily available, while necessary changes in the budgeting process are less extreme and thus easier to implement. For instance, one easily can attain both higher internal transparency and provide better quality financial data to external stakeholders by switching from local generally accepted accounting principles to International Financial Reporting Standards as the basis for monthly, quarterly, and annual reports. Similarly, controlling for economic or shareholder value creation encourages further development of familiar, proven instruments like target costing, which one then can analyze and interpret on more levels of a given business. Such incremental changes in a firm's budgetary process have the added advantage that its controller can continue to orient him- or herself on well understood, concrete numbers, calculations, and percentages.

Moreover, controlling on the basis of Better Budgeting or Advanced Budgeting in no way hinders inclusion of "soft" goals in a company's controlling system, say, by integrating a Balanced Scorecard into it. Doing so often is sensible because employee and customer satisfaction are intangible assets not reported on a balance sheet, but which strongly influence an enterprise's ability to earn profits in the future. Most businesses with BSCs in place, however, do not currently include them in reports to their oversight board and the annual shareholders' meeting.

The researchers, who discovered great dissatisfaction with budgeting in their 2003 survey of European firms (referred to at the outset of this article), repeated it in 2005. They again included 80 companies of different sizes from a range of industries. This time they found the businesses, as planned, generally had attempted to improve their budgeting processes. But the companies had undertaken far smaller, less radical reforms, at a much more leisurely speed than many academics and consultants perhaps had expected. At most, the researchers could classify just 18% of the reform projects as path-breaking in terms of heightened effectiveness or efficiency. As a result, these organizations had not markedly shortened their planning and budgeting processes relative to 2003. The average duration continued to be four months, while more than a quarter of the respondents said they needed at least five months. Furthermore, fully 70% of the surveyed enterprises still were dissatisfied with their planning and budgeting processes. Management's expectations with regard to effectiveness and efficiency remained unfulfilled.

Remedies

These findings must be particularly sobering for anyone hyping one of the budgeting reform models. Perhaps some factors inhibiting implementation of Beyond Budgeting also may be hindering implementation of Better Budgeting and Advanced Budgeting. In any event, there obviously still is a lot to do in the area of modernizing planning and controlling systems. With such high and widespread levels of dissatisfaction, it is no wonder that 69% of the respondents said their firm intended to overhaul its budgeting process again within the next one to two years (Oldiges, 2005)!

In many instances the continuing dissatisfaction with an organization's resource allocation process stems mainly from the large amount of time consumed in the budget's preparation and the inflexibility in its use. In those cases, one often can improve the process markedly, within the

framework of established operating procedures, by formulating rolling budgets to gain flexibility and adapting them to the business plan to ensure they comply with long-run strategy. Proceeding in this fashion is just one way a company can revamp its existing budgeting process for the better by implementing long-established, basic measures.

Additionally such measures leading to a leaner budget process include:

- concentrating on the business processes critical for success and thereby reducing the need for supporting sub-budgets and financial goals;
- refining the budgeting system by desisting from tactical planning;
- setting market-oriented goals instead of budgeting based on extrapolations from historical data;
- relying on quick preview information instead of detailed, budget-based prognosis calculations;
- abandoning the calendar year as the budget cycle's basis and transitioning to milestone (*i.e.*, rolling) budgeting (Leyk, 2006);
- reducing the frequency and number of budget controls to more carefully focus reporting; and
- simplifying the budgetary process by reducing the number of cost classifications involved. For example, a recent case study found that in a budget involving 38 cost categories, just 8 covered 82% of the total costs (Horváth, *op. cit.*). Rather than plan each in detail, it therefore would be simpler, quicker, and more efficient to group the other 30 cost types together in a single "other costs" class and make detailed plans for a total of only 9 cost categories.

Complementary organizational measures can increase flexibility further, while shortening the budgeting process. Such measures include:

- Strengthening the top-down-components of the organizational structure in order to reduce duplication, time consumed, and manual data entry errors (Binder, 2005). For instance, a firm can stop (the still widespread practice of) using one EDP system for revenues, another for cost planning, and a third for controlling, replacing them with a single integrated, standardized system.
- Simplifying the budget formulation and approval process, for example by concentrating on just a few important data about markets, products, employees, and stakeholders in the business.
- Decentralizing operational planning.

Pragmatic IT-Perspective

How large the uncertainty is in real-world companies, about whether one can do without budgets altogether, is apparent in the actions of major IT-suppliers. For instance, in Germany, SAP AG, Schlott Sebaldu AG, and Winterheller Software IT-Tools offer products to support Beyond Budgeting concepts from the IT-side: SAP SEM and Professional Planner. Nevertheless, their basis is the traditional integrated controlling cycle, which links strategic and operational planning with one another. With regard to the "right" controlling system, these suppliers thus effectively have assumed a neutral position and are trying to support all the reform variants simultaneously.

Who Should Be Onboard?

Whether an enterprise wants to develop its controlling concept along Better Budgeting, Advanced Budgeting, or Beyond Budgeting lines, putting it into action involves sweeping changes, which one cannot make simply in passing. Hence, inclusion of the entire management team in the reform process and attainment of the widest possible support within the firm for implementing the measures involved are essential preconditions for successfully introducing a new controlling model in practice. Inclusion of IT-experts is virtually unavoidable, in order to adapt existing information systems to the new concept's requirements. In addition, external human resource experts can perform valuable services with regard to facilitating change management. Finally, and above all, a significant commitment by the company's controllers is necessary, because they must shoulder the burden of conceiving the new planning, performance measurement, and controlling procedures.

Controllers nonetheless have nothing to fear from budgeting reform. Instead, it represents a huge opportunity for the controlling service. This opportunity lies in its using the reform process and freed-up resources to transform itself into a “business competence center” with the following duties:

- Strategic controlling,
- Controlling the organization’s value-adding processes,
- Providing data and information to decision-makers as well as both internal and external stakeholders as required,
- Selection, manipulation, analysis, interpretation, publication, and circulation of enterprise data,
- Continuous conceptual updating of the firm’s management systems.

Practitioners Are Pragmatic Too

The pragmatic decision made by IT-suppliers to support all the reform efforts seems well-taken. After all, practitioners choose their controlling tools and budgeting methods according to their needs, not according to conceptual discussions currently underway in academic literature.

This pragmatism is evident in recent case studies of GPC Biotech (Schmitt, 2005) and T-Online (Gleich and Hofmann, 2005). Both firms have internal and external environments exhibiting most of the characteristics conducive to introduction of Beyond Budgeting. Yet budgeting continues to play an important, though changing, role at the two companies.

Some elements of traditional budgeting remain. For example, resource allocation remains more centralized and top-down, especially with regard to investment in research projects, than foreseen by any of the three budgeting reform concepts.

However, their slimmed down operational budgetary processes combine top-down and bottom-up components. In addition, neither business budgets on a calendar-year basis or uses budgets for performance evaluations purposes any more. Such measures are notions associated with Better Budgeting and Advanced Budgeting.

One also can find certain elements of Beyond Budgeting at GPC Biotech and T-Online: capability to respond quickly to environmental changes; frequent checking of the linkages between strategy and operations; decoupling of the forecasting and controlling functions from budgeting; rolling plans with built-in forecasts; and a culture of continuously questioning and eliminating costs.

Assuming the experiences of GPC Biotech and T-Online are broadly representative of firm behavior, one can see that budgetary reform occurs gradually in an undogmatic, piecemeal fashion. In this way, companies stitch together a coherent set of modifications to their resource allocation processes. As a result, they are able to modernize and even replace certain functions of their budgets, while minimizing undesirable side effects.

Conclusions

Better Budgeting and Advanced Budgeting – in contrast to Beyond Budgeting – do not call an organization’s current management model fundamentally into question. Instead, the two former concepts concentrate on improving the efficiency of existing budgeting processes within largely unchanged framework conditions. Slimming down these processes in particular leads to more efficient use of management’s scarce time resources. It also is less risky. Accordingly, Better Budgeting and Advanced Budgeting projects are less susceptible to spectacular failure.

But, if the premises for a budget-based coordination of activities no longer exist, the real problem is in the managers’ heads, and a change in standard operating procedures is desirable rather than just efficiency gains in the budgeting process, then both of these propositions will fall short. In that case, introducing some elements of Beyond Budgeting may be in order. For practitioners, it thus is wise to invest time and effort in a careful analysis of the firm’s initial situation to determine what it really requires. Not always, but quite frequently, the simpler way to modernize planning and controlling systems may be the better way too.

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